

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

August 25, 2006

In Reply Refer To:
Southern Natural Gas Company
Docket Nos. RP05-684-001 and
RP06-192-001

Southern Natural Gas Company
P.O. Box 2563
Birmingham, Alabama 35202-2563

Attention: Glenn A. Sheffield
Director - Rates

Reference: Maintenance Capital Surcharge Filings

Dear Mr. Sheffield:

1. This order addresses Southern Natural Gas Company's (Southern) maintenance capital surcharge filings in Docket Nos. RP05-684-000, RP05-684-001, RP06-192-000, and RP06-192-001. As discussed in further detail below, the Commission accepts Southern's compliance filings, removes the refund conditions, and terminates the proceedings.
2. Section 31 of the General Terms and Conditions (GT&C) of Southern's tariff established a mechanism to recover through a volumetric surcharge the cost of service effect of certain maintenance capital expenditures. Section 31.1 of Southern's tariff defines capital maintenance expenses as: all prudently incurred capital expenditures placed in-service after February 28, 2005 for pipeline systems repairs, improvements, replacements or for support of pipeline operations, including, but not limited to, improvements or updates of information systems or costs relating to the enhancement of system security...undertaken pursuant to FERC regulations governing such replacement, repair or construction (including facilities constructed under the provisions of Southern's blanket certificate authority). Maintenance capital expenditures shall not include: (i) any costs attributable to an expansion of company's system; (ii) any costs associated with construction of delivery points or receipt point facilities under section 6 of Rate Schedule

FT, section 7 of Rate Schedule FT-NN or section 36 of these General Terms and Conditions; or (iii) those facilities constructed under the certificate order issued by the FERC in Docket No. CP04-340.

3. On September 30, 2005, in Docket No. RP05-684-000 (September filing), Southern filed revised tariff sheets to establish its initial maintenance capital surcharge at \$.0152 per decatherm (Dth) pursuant to section 31 of the GT&C of its tariff for the period November 1, 2005 through February 28, 2006. On October 31, 2005 the Commission issued an order¹ that accepted and suspended the revised tariff sheets, subject to refund and conditions and subject to allowing the parties 20 days to respond to Southern's October 24, 2005 answer to the issues raised by the parties in the Docket No. RP05-684-000 proceeding.

4. On January 31, 2006, in Docket No. RP06-192-000 (January filing), Southern filed revised tariff sheets to establish its second maintenance capital surcharge at \$.01 per Dth for the period March 1, 2006 through February 28, 2007. On March 1, and March 2, 2006, respectively, the Commission issued orders² which required Southern to provide detailed descriptions for the maintenance capital expenditures in excess of \$50,000, to explain the allocation of qualifying and non-qualifying capital expenditures, and to explain whether any costs included in its September and January filings and in future annual maintenance surcharge filings were attributable to an expansion of Southern's system.

5. On March 31, 2006, Southern submitted its compliance filings in Docket Nos. RP05-684-001 and RP06-192-001 to comply with the Commission's March 1 and March 2 Orders, respectively. In its compliance filings, Southern provided detailed descriptions of expenditures in excess of \$50,000 and equal to or less than \$250,000 in Schedule 1. Southern asserts that it has complied with section 31.1 of its tariff which provides that capital expenditures are to be excluded (*i.e.* non-qualifying). Southern states that it did not include any costs attributable to expansion projects in its September or January filings. Further, Southern claims that with respect to capital expenditures that are not clearly identifiable with a particular expansion project that none of the costs included in the September or January filings are allocable to any non-qualifying capital expenditures.

¹ See *Southern Natural Gas Co.*, 113 FERC ¶ 61,112 (2005) (October 31 Order).

² See *Southern Natural Gas Co.*, 114 FERC ¶ 61,227 (2006) and *Southern Natural Gas Co.*, 114 FERC ¶ 61,235 (2006) (March 1 and March 2 Orders).

6. Specifically, in Southern's compliance filing in Docket No. RP05-684-001, Southern states that Schedule 2 shows that the total amount of general plant and intangible plant is \$6.5 million and in Southern's compliance filing in Docket No. RP06-192-001, the Schedule 2 amount is \$13.7 million, which consists primarily of computer equipment, transportation vehicle replacement equipment, and non-expansion related enhancements to Premier, Southern's electronic bulletin board. Southern claims that it has determined that these items are not attributable to any non-qualifying capital expenditures relevant to either the September or January filings.
7. Additionally, Southern states that for comparison purposes it has provided in Schedule 3 the non-qualifying capital expenditures corresponding to the time periods covered by the September and January filings. Southern explains that for the September filing regarding the \$18.4 million, and for the January filing regarding the \$20.2 million under Docket No. CP04-340, which constitutes over 90 percent and 91 percent, respectively, in both filings of the non-qualifying capital expenditures, that this project included the abandonment of over 200 miles of pipe as well as 12 meter stations in Georgia. Further, Southern states that the cumulative non-qualifying capital expenditures which correspond to the time period covered by the January filing total \$22.1 million.
8. Lastly, Southern states that the project included installing six miles of new pipe and building five new meter stations which resulted in a net reduction in facilities on Southern's system, therefore the level of general and intangible plant supporting the net project facilities is less, rather than more. Consequently, Southern states that no general or intangible plant included in the September or January filings were allocated to this project and the remainder of non-qualifying capital expenditures was for expansion projects which were placed in service prior to March 1, 2005, but continued to incur capital expenditures beyond the in-service dates.
9. Public notice of Southern's compliance filing in Docket No. RP05-684-001 was issued on April 12, 2006 with protests due on or before April 19, 2006. Public notice of Southern's compliance filing in Docket No. RP06-192-001 was issued on May 11, 2006 with protests due on or before May 18, 2006. On April 19, 2006 and May 18, 2006, Peoples Gas System (Peoples), a division of Tampa Electric Company, filed protests in both filings, which are discussed below. On May 8, 2006 and May 26, 2006, Southern filed answers to Peoples' protests. Pursuant to 18 C.F.R. §385.213(2006), answers to protests are not permitted. The Commission finds Southern's answers provide information useful in the examination of its compliance filings and therefore, the Commission accepts Southern's answers.
10. Peoples notes in its April 19, 2006 comments in Docket No. RP05-684-001, that it appreciates both the additional information provided by Southern regarding the \$50,000 and above threshold for detailed reporting of expenditure items and Southern's

explanation with respect to the allocations and non-qualifying capital expenditures, but it still has a few remaining concerns. First, Peoples is concerned with Southern's choice between repairing or replacing an existing facility which may impact whether the associated costs will be treated as maintenance capital expenditures or operation and maintenance (O&M) expenses. Peoples states that with respect to many items on Southern's list of maintenance capital expenditures that represent facilities replacements, it questions whether a repair and O&M expenses may have sufficed. Peoples also states that the capital maintenance surcharge mechanism could provide an incentive for Southern to take the replacement option even where it is not needed. Peoples states that these items warrant close scrutiny and that Southern's descriptions of replacement items should explain the choice of options.

11. Further, Peoples asserts that the matter of facilities replacement also raises the question of salvage value, and that if Southern is able to obtain value from the replaced facilities that value should be credited to the cost of replacement to be recovered in the maintenance capital surcharge. Peoples states that there is no information provided by Southern regarding its treatment of revenues from the salvage of replaced facilities. Also, Peoples states that certain expenditures, by their nature, such as replacement of desktop and laptop computers, tools, shop and garage equipment and replacement of pipeline waterway signs, appear to be at the margin between capital expenditures and O&M expenses. Peoples asserts that the maintenance capital surcharge mechanism should not be treated as a catch-all and conduit for cost recovery for items more properly treated as O&M expenses.

12. Peoples claims that Southern has placed an unduly broad interpretation on the "support for pipeline operations" phrase contained in section 31.1 of Southern's tariff. Peoples asserts that the phrase was never intended to subsume all overhead costs incurred by Southern, no matter how remote the nexus with pipeline operation *per se*. However, Peoples states that Southern has included such items as furniture and supplies, renovation of the Birmingham office, computer and communication equipment, among other general plant items, in its list of maintenance capital expenditures. Peoples states that to the extent that such facilities and equipment are properly classified as maintenance capital expenditures in the first place and support the entirety of Southern's operations, including expansion and other non-qualifying endeavors, there should be an allocation of the facility and equipment costs between qualifying and non-qualifying matters and the portion allocated to non-qualifying matters should not be included in the maintenance capital surcharge.

13. Finally, in its comments filed on May 18, 2006 in Docket No. RP06-192-001, Peoples states that the issues it raises are in common with those raised in Docket No. RP05-684-001 and that the both filings should be reviewed in that light. Peoples states that it does not understand Southern's claim that it has "projected no non-qualifying

expenditures during the projection period of January 2006 through February 2007,” considering that the Cypress project, an expansion project is scheduled to commence operations in May 2007 has only received preliminary certification. Further, Peoples claims that it does not wish to force extensive discovery or prolonged litigation. It states that its sole desire is to ensure that the proposed maintenance capital expenditure filings be subjected to meaningful review, so that the maintenance capital surcharge is limited to the purpose for which it was intended.

14. In its May 8, 2006 answer in Docket No. RP05-684-001, Southern responds that it has fully complied with the Commission’s March 1 Order in sufficient detail regarding the capital expenditures made during the designated period. Southern states that its obligation under section 31 of its tariff is to accurately describe and list the items that are included in the maintenance capital surcharge filing and that it has met the burden of proof to show that the surcharge has been properly calculated. Further, Southern claims that Peoples has not shown that any of the items listed were improperly or incorrectly included in the maintenance capital surcharge filing. Southern states that Peoples has no basis for claiming that Southern did not use proper accounting in capitalizing certain costs and that the additional information filed by Southern in the compliance filing should give Peoples and the Commission sufficient data to fully analyze whether Southern has calculated the surcharge properly.

15. Southern also states that the issues raised by Peoples are either so minor as to have no effect on the calculation of the maintenance capital surcharge given the rate cap or are old issues unrelated to the instant compliance filing that Peoples should have raised at the time of the initial filing. According to Southern, it stated, in an earlier answer, that there would have to be exclusions of at least \$8,000,000 of expenditures in order to effectuate a reduction in the surcharge because of the rate caps negotiated in the rate case settlement. Therefore, Southern claims that the rate caps negotiated in the rate case settlement offer more economic protection for the parties than disputing the multitude of minor capital expenditures filed in the instant compliance filing.

16. Further, Southern states that Peoples does not accurately portray in Peoples’ comments regarding what section 31.1 of its tariff defines as the maintenance capital expenditures to be included in its maintenance capital surcharge calculation. Section 31.1 of Southern’s tariff states that:

Maintenance Capital Expenditures are defined as all prudently incurred capital expenditures placed in-service after February 28, 2005, for pipeline operations, *including, but not limited to, improvement or updates of information systems* or costs relating to the enhancement of system security, or in response to the U.S. Department of Transportation, U.S. Department of the Interior, FERC, or other state or federal regulations or

requirements or other safety or environmental laws or regulations, undertaken pursuant to FERC regulations governing such replacement repair or construction ...

Southern states that the “including but not limited to” phrase lists specifically “improvements or updates of information systems.” Southern claims that computer and communications equipment would obviously constitute an improvement or an update of information systems and that Peoples comments questioning Southern’s interpretation of “support for pipeline operations” ignores the clear intent of the maintenance capital surcharge as defined in section 31 of its tariff.

17. Southern requests that the Commission approve the maintenance capital surcharge filing and remove the refund condition imposed by the Commission. Southern states that, given the fact that the maintenance capital surcharge filing went into effect on March 1, 2005, and was calculated consistent with the provisions of section 31 of its tariff, there is no dispute that requires extensive discovery or prolonged litigation. It states that section 31 of its tariff contemplates that the surcharge will be collected within five discrete annual periods which are capped at an agreed upon, negotiated amount. Southern states that Peoples’ strategy seems to be to force litigation over the prudence of replacing minor items such as office furniture, laptop computers and waterway signs and that litigation over such items would be a waste of resources for all parties when the exclusion of these items from the maintenance capital surcharge would have no effect. Southern states that it has complied with the requirements of section 31 of its tariff with respect to the level of detail in the maintenance capital surcharge filing and that further debate about specific maintenance capital expenditures included in Schedule 3 of the instant compliance filing is unnecessary and therefore it requests that the Commission accept the maintenance capital surcharge filing in Docket No. RP05-584-000 and the compliance filing in Docket No. RP05-684-001 without condition.

18. Lastly, in its May 26, 2006 answer in Docket No. RP06-192-001, Southern states that it has fully complied the Commission’s March 2 Order and that it has met the burden of proof required by its tariff to show that the surcharge has been calculated correctly. Southern reiterates the arguments it offered in its initial answer to the compliance filing in Docket No. RP05-684-001 and requests that the Commission accept the maintenance capital surcharge filing in Docket No. RP06-192-000 and the compliance filing RP06-192-001 without further condition.

19. The Commission finds that Southern has satisfactorily complied with the directives of the Commission’s March 1 and March 2 Orders, and accepts Southern’s compliance filings. We also find that Southern’s interpretation of its tariff is reasonable because it includes expenditures that are defined and permitted under section 31 of its tariff and therefore it has met its tariff obligation. Additionally, as Southern points out in its

answers, we find that the expenditures that Peoples is questioning in the compliance filings appear to have no little or no impact on the maintenance capital surcharge due to the rate caps set forth in Southern's tariff. Therefore, the Commission hereby accepts the compliance filings, removes the refund conditions imposed in Docket Nos. RP05-684-000 and RP06-192-000, and terminates the proceedings as discussed herein.

By direction of the Commission.

Magalie R. Salas,
Secretary.